

Office of Chief Counsel
Internal Revenue Service

memorandum

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HPLevine, ID# 62-09574

date: 4/16/00

to: Chief, Examination Division, Kentucky-Tennessee District
Attention: Revenue Agent Don Kotval

from: District Counsel, Kentucky-Tennessee District, Nashville

subject: [REDACTED]
Partnership depreciation in I.R.C. § 721 transaction

DISCLOSURE STATEMENT

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ISSUES:

1. Whether assets transferred during the last quarter of a taxable year by members of a consolidated group of corporations to a partnership in non-recognition transactions under I.R.C. § 721, that were placed in service by the corporations in *previous taxable years*, are subject to the mid-quarter convention?
2. Whether assets transferred during the last quarter of a taxable year by members of a consolidated group of corporations to a partnership in non-recognition

transactions under I.R.C. § 721, that were placed in service by the corporations in the *same taxable year*, are subject to the mid-quarter convention?

CONCLUSIONS:

1. Assets transferred during the last quarter of a taxable year by members of a consolidated group of corporations to a partnership in non-recognition transactions under I.R.C. § 721, that were placed in service in *previous taxable years*, are not subject to the mid-quarter convention. Rather they must be depreciated for the period in which the assets were in service by the respective entities.
2. Assets transferred during the last quarter of a taxable year by members of a consolidated group of corporations to a partnership in non-recognition transactions under I.R.C. § 721, that were placed in service in the *same taxable year*, are subject to the mid-quarter convention.

FACTS AND DISCUSSION:

Subsidiaries of the consolidated parent, [REDACTED], the predecessor to [REDACTED], transferred hotel properties to a newly formed partnership in [REDACTED] in a transaction that qualified for nonrecognition treatment under I.R.C. § 721. They purportedly did this for State excise taxes. The partnership was formed on [REDACTED]. The assets were not transferred until [REDACTED], when the partnership claimed that it commenced operations. The assets, which totaled over \$[REDACTED], were transferred for the partnership interests. The transaction qualified as a tax-free transaction under I.R.C. § 721. The transferred assets consisted both of assets placed in service in years prior to the year in which the transfer occurred and assets of approximately \$[REDACTED] that were placed into service by the corporation in the same year as the transfer. The partnership depreciated the assets under a half-year convention in the year of transfer. The partners were subsidiary corporations who were members of the [REDACTED] consolidated return.

The depreciation deduction allowed or allowable under I.R.C. § 167(a) is determined by using: (1) the applicable depreciation method; (2) the applicable recovery period; and (3) the applicable convention. I.R.C. § 168(a).

The general rule for determining the proper convention is contained in I.R.C. § 168(d)(3), which provides that property placed into service during the last 3 months of the year which exceeds 40% of the aggregate basis of all of the property placed in service in the taxable year must use the mid-quarter convention. However, under I.R.C. § 168(i)(7), the transferee (the partnership) in a transaction described in I.R.C. § 721, is treated as the transferor (corporation) for depreciation purposes. Treas. Reg. § 1.168(d)-1(b)(6) provides that in the case of property placed in service, the determination is made at the partnership level. Treas. Reg. § 1.168(d)-1(b)(7) addresses **certain** recognition transactions.

It appears that Treas. Reg. § 1.168(d)-1(b)(7) was intended to address the relationship between I.R.C. § 168(d)(3)(B) and I.R.C. § 168(i)(7). Under I.R.C. § 168(d)(3)(B), **property acquired and disposed of in the same taxable year** is not taken into account in determining whether the 40% aggregate rule has been satisfied. Treas. Reg. § 1.168(d)-1(b)(7) reinstates that rule for related parties.

Treas. Reg. § 1.168(d)-1(b)(7) does not apply for the pre-[REDACTED] assets since those properties were initially placed into service in a year **preceding** the year in which the property was transferred and the transfer did not occur in the same year that the property was initially placed in service. We agree that Treas. Reg. § 1.168(d)-1(b)(7) applies for the assets placed in service by the corporate transferors in [REDACTED], which were transferred to the partnership transferees. Although the transferors were members of a consolidated group, the partnerships are not considered to be even though the partners were since the determination is made at the partnership level. Treas. Reg. § 1.168(d)-1(b)(6). All of the assets transferred by the corporate transferors to the partnership transferee were in the last three months of [REDACTED]. These assets were comprised of two groups: (1) pre-[REDACTED] placed in service assets; and (2) [REDACTED] placed in service assets. Considering the [REDACTED] placed in service assets as a separate group, [REDACTED]% of the assets were placed in service in the last three months of [REDACTED] and therefore, the mid-quarter convention applies.¹

¹ We agree with Revenue Agent Kotval that while ambiguous, the clear intent of the regulation is to address the [REDACTED] placed in service assets. Another way to read the regulation would be to determine the 40% by comparing the assets placed in service by the partnership which were acquired by the corporations in [REDACTED] against all property transferred in [REDACTED] even if acquired pre-[REDACTED]. In that instance, the 40% test would not be satisfied

I.R.C. § 168(i)(7) provides, in part, that in the case of property transferred in a transaction described in I.R.C. § 721, the transferee is treated the same as the transferor for purposes of determining the depreciation deduction. Since I.R.C. § 168(i)(7) applies in this case, the transferee partnership "steps into the shoes" of the transferor corporations for depreciation purposes. In other words, the transferee partnership continues to depreciate the transferred property in the same manner (recovery period, method, and convention) as the transferor corporations. The depreciation convention rules discussed above are applicable when property is initially placed in service. To the extent that pre-████ placed in service property was transferred by the transferor corporations in █████, the convention rules do not come into play upon the transfer of the property to the partnership. Rather, I.R.C. § 168(i)(7) applies and the transferee is considered to be the transferor for determining the allowable depreciation deductions.

In summary, in the present case, in determining the depreciation for the pre-████ placed in service property, the transferred property was held by the transferor corporations for █████ months and by the transferee partnership for █████ months. The depreciation allowable for the year of the transfer should be allocated on that basis - █████ for the transferor corporations and █████ for the transferee partnership. The property originally placed in service in █████ by the corporate transferor which was transferred to the partnership transferee is subject to the mid-quarter convention because of the application of Treas. Reg. § 1.168(d)-1(b)(7).

Please contact the undersigned at extension 5072 if you have any questions. We are requesting post-review from the National Office. Attached is a client survey which we request that you consider completing.

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By:

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since the property acquired and transferred in █████ (\$████) does not exceed 40% of the aggregate assets transferred (\$████).
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